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WHO WILL REALLY BENEFIT FROM THE NEXT GENERATION EU FUNDS?

Policy Insight

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Who will really benefit from the Next Generation EU funds?

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Southern and central-eastern European countries will be the biggest beneficiaries of financial support under the new EU Recovery and Resilience Facility and React-EU, as well as of the new Multiannual Financial Framework. Two main risks might reduce the economic impact of these instruments, however: i) the traditionally slow absorption rate of European structural investment funds and ii) limits to the capacity of national governments to channel very large amounts of public investment.

After the July Council agreement that approved the Next Generation EU, member states are now preparing their first-draft national recovery and resilience plans, to be presented to the Commission by October 15th and finalised by April next year.

The key novelty of the Next Generation EU instrument (NGEU) is the Recovery and Resilience Facility (RRF) and React-EU.[1] Since the criteria governing allocations under these grants are the (inverse) per-capita income ratio in 2019 (relative to the EU average) and pre-crisis unemployment rates (average over the period 2015-19), southern and central-eastern European economies are expected to benefit most from these grants.

[1] Together, RRF and React-EU account for more than 95% of the NGEU grants.

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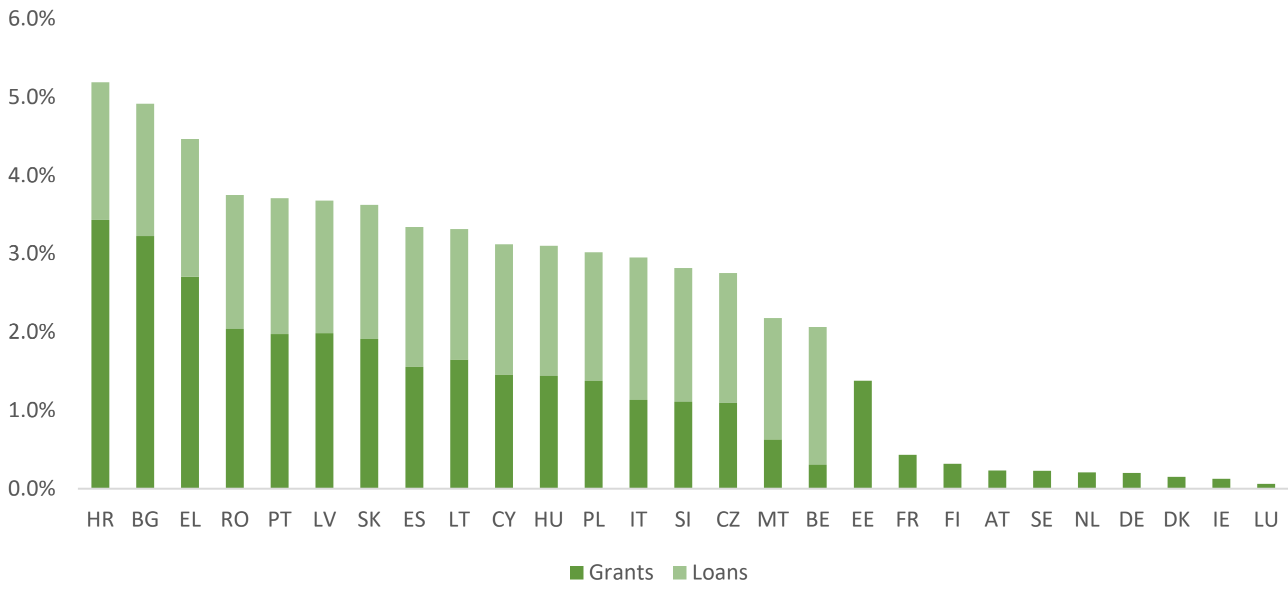
These countries are also expected to request NGEU loan support, as was already the case under SURE. The reason is that these countries are the most indebted (southern member states) and have the smallest economies (central-eastern member states). They are thus likely to benefit from the lower interest rates applied by the EU relative to market rates.

The total NGEU support, combining loans and grants, to individual southern and eastern-European member states can be as much as 3% to 5% of domestic GDP each year over the period 2021-24 (see Figure 1).

Figure 1. Annualised NGEU loans and grants support per member state (% GDP 2021)



Source: own calculation, based on European Commission data (2020).[2]

Furthermore, we should also remember that these resources will top up the traditional EU transfers from the next Multiannual Financial Framework 2021-27. The same countries are also the biggest beneficiaries of Structural and Investment funds (European Social Fund Plus, European Regional Development Fund and Cohesion Fund) and will receive significant support from the Just Transition Fund and the European Agricultural Fund for Rural Development. All in all, southern and centre-eastern member states will have to absorb between 4% and 8% of GDP from the NGEU and the MFF funds, every year. Interestingly, MFF funds will continue to be directed mostly to central-eastern member states, whereas the NGEU will prioritise southern countries (see Figure 2).

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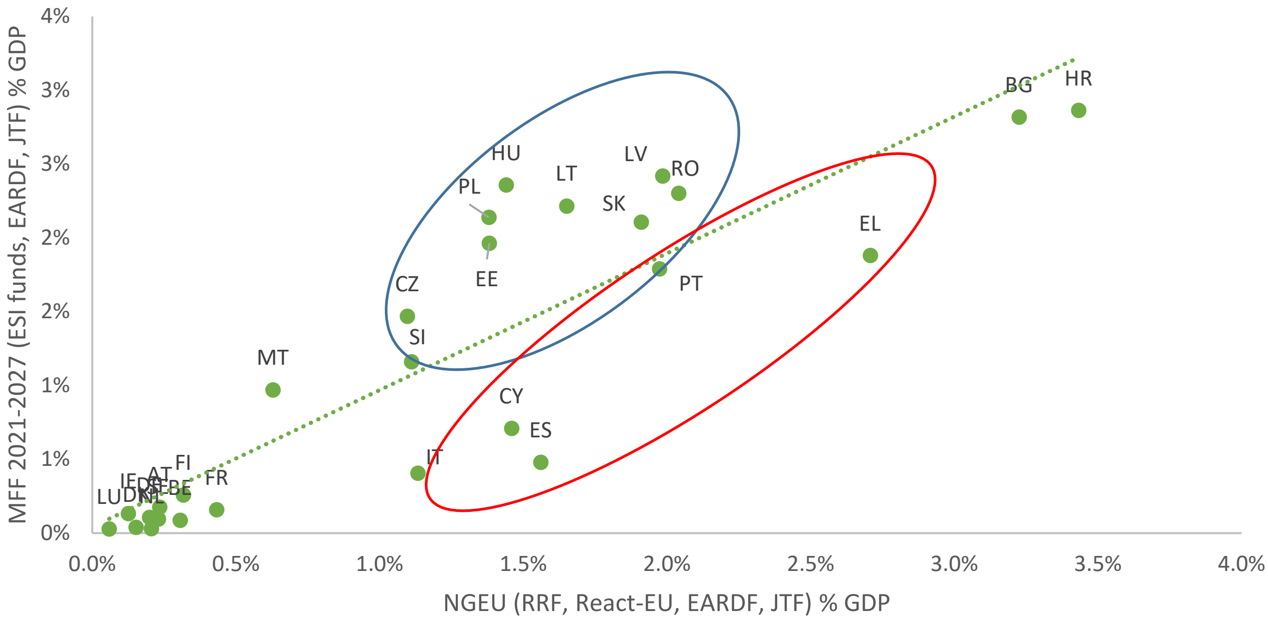
[2] See, for the RRF: https://ec.europa.eu/info/sites/info/files/1_en_annexe_proposition_part1_v15.pdf; for React-EU: https://ec.europa.eu/info/sites/info/files/com_2020_451_en_annexe_v1.pdf and for EUCO: https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf

Figure 2. Annualised MFF 2021-27 and NGEU grants (%GDP)



Source: own computation, based on European Commission (2020).

This level of resources is considerable by any metric, and raises the question of whether national governments will be able to absorb them. There are two main risks to this prospect.

The first is not new and relates to the capacity to absorb EU Structural and Investment funds. How quickly a country absorbs EU funds usually depends on its capacity to identify and implement projects in line with the national operational programme agreed with the Commission. Based on previous experience, absorption rates are very high – close to 95% of the allocated funds, but delays are the rule rather than the exception. Most of the time, funds are fully absorbed only three years after the end of the programming period. The state of implementation of the current MFF, which is about to end, suggests that southern and central-eastern countries have the lowest absorption rates, and in some cases they have used only one-third of the total funds allocated.[3] This might represent a serious obstacle to the effective implementation of the NGEU.

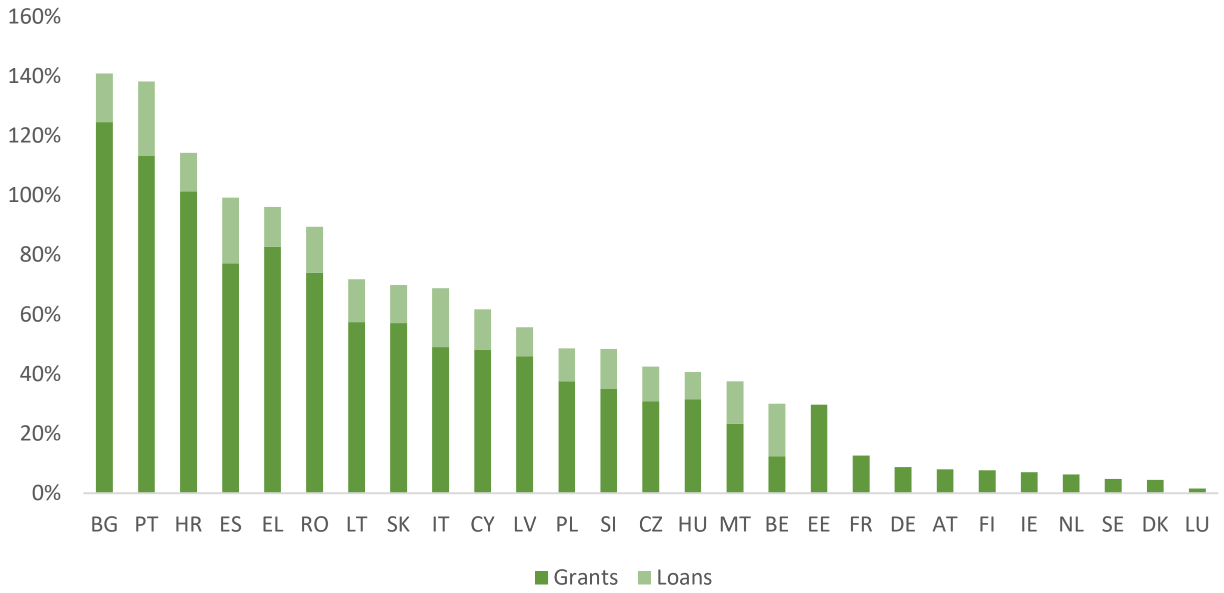
The second risk relates to the capacity of member states to use the EU grants and loans for additional public investments.

According to the Commission's stylised simulations presented in May 2020, the entire Next Generation EU package could raise real GDP levels by around 2% by 2024 on average. A critical basis underlying these results is that the Commission assumes that member states will use 50% of the NGEU loans and 100% of the NGEU grants for additional public investments.

[3] See European Commission.

This scenario, although highly desirable, seems rather unrealistic. Under the assumption of a 100% absorption rate and full additionality, the yearly public investments for Bulgaria, Portugal, Croatia, Greece and Spain should more than double over the next four years. For 11 other countries, investment would increase by between 90% and 40% (see Figure 3).

Figure 3. Annualised NGEU allocation (loans and grants): governments' general gross fixed capital formation (average 2016-19)



Sources: own calculation, based on European Commission and AMECO.

Based on past data, increases in public investment much in excess of 10-20% per annum occur rarely. Over the last four years (2019-16) the EU-27 general government gross fixed capital formation increased by 20% (over four years), with Eastern member states always performing better but still way below 100%. In practice, larger increases are also likely to lead to inefficiencies and bottlenecks.

It would appear materially impossible for the main beneficiaries of the RRF and React-EU to use the funding (grants and loans) made available to them only or even mainly to increase public sector investment. Doubling public sector investment for four years would in any case not make sense, if the investment cannot be maintained thereafter.[4] It is thus clear that most of the NGEU funds will have to be used for wider budgetary support, possibly to support private investment.[5]

[4] Government expenditure on R&D accounts for only 0.2-0.3 % of GDP in most of the recipient countries. This implies that it will not be possible to spend a major portion of these funds on research.

[5] The Working Document of the Commission acknowledges this where is says "the note suggests a cumulative drop in investment of €846bn in 2020 and 2021 taken together, of which €831bn is accounted for by lower private investment."

The scant detail available from the very first drafts of some national NGEU reveals the reality. The Italian plan envisages that a large part of the funding will be used to facilitate firms' access to capital and liquidity. Similarly, in France, the majority of the projects to stimulate competitiveness are corporate tax measures.

Increasing public sector investment is always desirable, but in practice, only a small portion of the large funding from the NGEU can be used to finance public sector investment.

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